United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

76-5009

UNITED STATES COURT OF APPEALS
Second Circuit

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In the Matter of :

UNISHOPS, INC., et al :

Debtors :

143 ESTATES, et al :

Appellants :

-against- :

UNISHOPS, et al :

Appellees :

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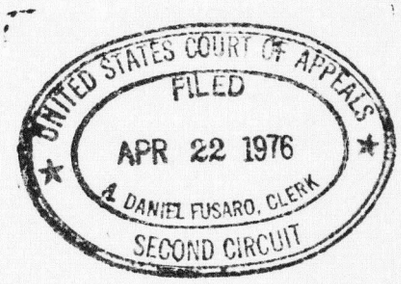
Docket No. 76 - 5009



APPELLANTS' BRIEF.

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STATEMENT

This is an appeal from an Order of District Court Judge Frankel, which affirmed that part of Bankruptcy Judge Babitt's Order in respect to a $417,000 claim for administration expenses based on appellee's guaranty of rent, filed by appellant against the estate of appellee UNISHOPS in its Chapter XI proceeding. Both Judges reclassified the claim as general. Said Order of Judge Frankel reversed Bankruptcy Judge Babitt's Order in respect to a $42,000 claim against appellee MIDDLETOWN likewise for administration expense rent and filed in its Chapter XI proceeding. Judge Babitt had refused to reclassify the claim as general. Judge Frankel did so reclassify it.

Appellees had moved to reclassify these claims as general claims with the foregoing results. The issue presented for review is whether the aforesaid claims are to be classified as general or administration expense claims.

While 143 ESTATES, INC. and a number of entities similarly situated are appellants, they will be referred to for the most part as claimant. Appellee UNISHOPS will be mostly referred to as UNISHOPS. Appellee MIDDLETOWN will be referred to mostly as MIDDLETOWN. The term DIP means debtor-in-possession.

FACTS

There is no dispute. Judge Babitt's opinion sets forth the facts. Part of the record is an agreed statement of facts. Thus, we shall not refer to the record to indicate where a particular fact is documented. If our adversary takes issue with any of our factual assertions, in a reply memorandum, we will indicate that part of the record wherein the same is documented.

UNISHOPS filed a Petition in Chapter XI on November 30, 1973. Its wholly owned subsidiary MIDDLETOWN did not file until September 30, 1974. Claimant had become landlord by acquiring the fee for $4,000,000, a key element of the deal being that UNISHOPS, which sold claimant the fee, would become itself by guarantee independently bound to perform the lease to MIDDLETOWN. In return, UNISHOPS' subsidiary MIDDLETOWN got a long term lease and was given the right, without prior approval, to and did sublease portions of the premises free from any restrictions of claimant.

For the first 4 months of guarantor UNISHOPS' Chapter XI, namely November and December 1973, and for January and February 1974, appellant was paid rent not by the lessee, MIDDLETOWN, but by guarantor UNISHOPS or its affiliate, WHITE'S DEPARTMENT STORE. For the next seven months, no rent was paid and the $417,000 claim is for that rent, under UNISHOPS' independent obligation to pay same. During said seven months, UNISHOPS, MIDDLETOWN and their subtenants had the keys and actually exercised absolute control over the premises. Their affiliate, WHITE'S DEPARTMENT STORE, actively operated through May, stored equipment

till late summer and the subtenants operated through the entire interval.

Lessee MIDDLETOWN, on September 23, 1974, in its Chapter XI proceeding, procured an Order disaffirming the lease as of September 30, 1974. Guarantor UNISHOPS, never sought disaffirmance of the guaranty or any classification or limitation thereof.

We continue to set forth the facts from the standpoint of Section 64 of the Bankruptcy Act which defines the prerequisite of administration expense claims to be that the obligation out of which they arise must constitute "the costs and expenses of administration including actual and necessary costs and expenses of preserving the estate subsequent to filing the petition". Also administration expenses are uniformly construed to include costs of operation of the DIP.

Needless to say, facts which constitute benefit to the estate contribute to its preservation. Facts within this category are manifold, substantial and continued operative from the time that UNISHOPS filed its petition on November 30, 1973, for almost ten months until September 23, 1974, when UNISHOPS' subsidiary procured a Court Order disaffirming the lease.

The continuing benefits to DIP UNISHOPS which we enumerate hereafter, eventuated as a result of claimant's non-interference with its lessee, MIDDLETOWN, by reason of its non-interference with the relationship of MIDDLETOWN to its sub-lessees and because of the affirmative performance by lessor-claimants of the covenants of the lease all in continuous reliance on the UNISHOP'S guaranty. These benefits were apart from and independent of other benefits which inured to lessee MIDDLETOWN and inured to UNISHOPS

for a long period before MIDDLETOWN ever filed in Chapter XI. This negates the contention that guarantors can derive no benefit from continued performance of lessor's obligations.

The facts constituting continuing benefits sought and received are:

1) Ability of parent, UNISHOPS, to control the entire demised premises of 20 acres on which was housed its subsidiary department store, a sublessee supermarket, departments leased under sub-leases and sub-lessee, CHEMICAL BANK, for interval November 30, 1973 (date UNISHOPS filed in Chapter XI) to September 23, 1974 when the belated attack on the major lease resulted in its rejection. CHEMICAL BANK remained on the demised premises for an extended period after September 23, 1974 with attornment only to UNISHOPS and refusal of UNISHOPS to assign sublease to claimant.

2) Ability of UNISHOPS to refrain from filing Chapter XI for its subsidiary-lessee, MIDDLETOWN, and for 19 other subsidiaries which were operating in various shopping centers between November 30, 1973 and September 3, 1974, with the attendant savings in costs and expenses to UNISHOPS and freedom to manage such subsidiaries without direct Court and Creditor Committee control had Chapter XI proceedings been filed for them.

3) Receipts derived by DIP UNISHOPS from active operation of its subsidiary, WHITE'S DEPARTMENT STORE, and the leased department rentals directly into its coffers between November 30, 1973 and May, 1974 when active business operations continued unabated in claimants' premises.

4) Continued accrual of rentals under sub-leases from some six sub-lessees as well as from CHEMICAL BANK for the interval prior to

rejection of the lease (November 30, 1973 to September 23, 1974) and for an extended period thereafter.

5) Advantage of continued exclusive control and possession of entire 20 acres in the matter of conducting going-out-of-business sales to benefit itself and the sub-lessees between March and June of 1974.

6) Benefit of retention of possession and control of demised premises for continued storage of fixtures and equipment of sub-lessees and of subsidiary department store between May 1, 1974 and September 3, 1974.

7) Quiet enjoyment on the part of the sub-lessees of continued use and/or store space without need to attorn to lessor, while DIP guarantor negotiated placement of business in other of its shopping center locations and negotiated settlements under which it stipulated to receive lump sum payments as, for example, with WALDBAUMS.

8) Retention of possession and control of entire 20 acre demised premises without payment of rent or other charges for the period of March, 1974 through to September 30, 1974, the effective date of the lease rejection order, said retention and possession resting upon the guaranteed lessor's forebearance in reliance on the guaranty.

9) Continuous physical maintenance by lessor, the claimants, of entire demised premises, furnishing utilities, security and advancing accruing taxes.

POINT I.

THE $417,000 CLAIM SHOULD BE AN ADMINISTRATION EXPENSE CLAIM

Both Judges below held that the claim on the guaranty was a general claim. Judge Babitt said that:

> "Grayson-Robinson (321 F. 2d 500) constrains me to hold that the agreement of guarantee is non-executory, and is a complete obligation effective on the date of execution."
> (hereinafter referred to as GRAYSON)

Judge Frankel followed suit, stating:

> "That a contract of guaranty is not executory because it holds no future benefit for the guarantor and, second, special facts arising out of the guarantor's relationship to the lessee were of no moment."

Our basic position is that GRAYSON never did prescribe an immutable rule that under all circumstances a pre-petition signed guaranty gives rise only to an executed contract incapable of maturing into anything but a general claim. Quite the contrary, GRAYSON indicated there were circumstances under which a guaranty could constitute an executory contract giving rise to an administration expense claim.

The strongest support (as we shall hereafter develop), for our position is the very opinion of Judge Babitt wherein in substance, he stated that although there were many facts and circumstances which should support a conclusion that the instant claim was executory, entitled to administration expense status, nevertheless he felt impelled by GRAYSON to hold otherwise and leave it up to this Court to define the orbit of GRAYSON.

Initially we note that GRAYSON did not deal with the question of the status of the claim as being general or priority. At issue was a motion to reject a pre-petition guaranty as an

onerous executory contract. Under Section 313 of the Bankruptcy Act only "executory contracts" may be rejected. The Court held, absent any other facts, that the guaranty was not an executory contract within the traditional meaning of the words "executory" or "guaranty". Accordingly, it followed and this Court so held that the claim could not be rejected. However, the Court in substance pointed out that its decision was mandated by the sparseness of the record which failed to disclose "the advantage of giving or receiving further performance". Does it follow that by reason thereof that under no circumstances could a pre-petition guaranty give rise to an administration status? Obviously no. The Court pointed out that some facts, if established, might result in a finding that the guaranty was executory, subject to rejection.

GRAYSON indicated a basic fact pattern (virtually identical with that in our case) which is rarely encountered. There, as here, petitions under Chapter XI for the subsidiary corporations were not filed although they were kept in control of the leased premises during and despite extended defaults under the leases. The tenor of the GRAYSON case is that the mere word "guaranty" does not under all circumstances necessitate the appellation of "executed" or "non-executory". It depends on the facts. In the GRAYSON case the Court said:

> "The question presented in the petition to review is simply one of law: Are guarantees of leases executory contracts which may be rejected pursuant to Section 313(1)of the said Act?

We are asked to review on the basis of the question so stated, the district court's affirmance of the referee's order.

Rarely can a legal question put thus in vacuo be answered with confidence. The present case is not one of these rare exceptions.

We are told little in the slender record before us except that when the petition under Chapter XI was filed appellant operated a chain of retail stores engaged in selling wearing apparel. Its stores were located in various cities throughout the country in quarters which were leased to appellant or to its subsidiaries. In most instances where the quarters were leased to subsidiaries, appellant guaranteed performance of the subsidiary's obligations under the lease, including payment of rent. It is guaranties of this type which are the subject of the present controversy. The subsidiaries have not been put into bankruptcy. However, all those subsidiaries the leases of which are involved in the present application have defaulted on their leases.

We are not told, nor are we disposed to speculate, as to why the appellant did not seek reorganization of the subsidiaries. We are not informed of the reason for the application to reject the guaranties. We do not propose to guess whether the appellant believes that rejection of its guaranties would result in some limitation on its liabilities under the leases which are defaulted, or whether such rejection would put the appellant in a stronger bargaining position with respect to leases which it wishes to continue.

The unsatisfactory character of the 'naked' question of law which has been certified is illustrated by the difficulty presented by the term 'executory contracts'. Williston notes that all contracts are executory 'to a greater or less extent'.

> 1 Williston, Contracts §14, at 28 (3d ed. 1957). In a sense, then, the question certified is meaningless apart from concretization based on the specific facts of the particular situation. In order to determine with confidence whether any particular contract is to be considered executory within the meaning of Section 313(1), we must know why the question is asked and what would be the consequences of the answer 'yes' or the answer 'no'.
>
> The appellant has at least the logical burden of persuading us that the answer given by the referee and the district court is not the correct answer. It could perhaps have discharged that burden by revealing the purpose of its motion, the function of the rejection of the guaranties in the reorganization process, the practical results of granting or denying its application. It has chosen not to do so but to leave us uninformed in those respects.
>
> On so barren a record we must answer the 'naked' legal question, 'no'."

Assuming for the sake of argument that in GRAYSON a claim on the guaranty had been filed by lessor was denominated administration expense and the debtor moved to reclassify it as general. Obviously, the prior GRAYSON classification of non-executory would not be at all determinative. The GRAYSON decision simply said it was the debtor's "burden of persuading us - it has chosen not to do so but to leave us uninformed ***." The inference is clear. The Court might have been persuaded to classify the claim as executory with all attendant attributes had sufficient facts been presented.

All that GRAYSON decided applicable to our case is that guarantees may be deemed executory, or non-executory depending upon the facts. The question as to whether the claim was administration expense or general, was not even considered.

Thus, under GRAYSON, the question of the status of a claim predicated upon a guaranty as being general or priority remains wide open. To the extent that the question hinges upon a label of executory or non-executory (executed), that label depends upon the facts. The same question under the opinion of Judge Babitt remains wide open. He points out various criteria whereby our pre-petition negotiated guaranty could readily be held to be a priority claim within the context of GRAYSON, but declines to so hold. He states (page 13 of decision) the following as a basis whereon this Court without conflicting with GRAYSON and in amplification thereof could and should hold our guaranty to be executory:

> "The guarantee should clearly be an executory contract within the meaning of Section 313(1) of the Act and in effect, until disaffirmed. That guarantee would therefore be a continuing obligation of the parent-guarantor from its Chapter XI filing through its subsidiary's defaults, and until the guarantee agreement is disaffirmed."

The Judge then proceeds to set forth various facts which if he were not constrained by GRAYSON would have led him to hold the claim to be an administration expense claim. He even went so far as to point out the unfairness of applying GRAYSON to the facts in our case:

> "*** Grayson-Robinson would permit a parent-guarantor to continue to derive the ultimate benefits of continued possession by its defaulting subsidiary

> based wholly on the lessor's reliance on the agreement of guaranty but without responsibility to pay. It would be far more equitable to concede the parent-guarantor's interest in the future performance by the claimant lessor of its promises in the lease with the subsidiary."

The facts in the case at bar were not before this Court in GRAYSON, and, if they had been we doubt that it would have denied administration status to the claim on the basis of labeling the guarantee an executed agreement. The question remains, why did Judge Babitt feel constrained by the GRAYSON case?

We, of course, can only speculate. We venture to suggest that since there was no reported case either way appraising the factual context in which a pre-petition guaranty might be held to be an executory claim benefiting the guarantor's estate and entitling it to administration status, he probably felt that this Court should make the first pronouncement on the subject. He considered the question to be open and ripe for delineation by this Court. Otherwise why would he have suggested "a focus to *** support a reappraisal of Grayson-Robinson?" Why would he have discussed the various criteria on the basis of which the guaranty might be deemed an administration claim? Why should he have said, as aforesaid, "*** <u>the guarantee should clearly be an executory contract</u>" (underscoring ours), and even went further and said:

> "The claimant, the subsidiary's lessor, should be allowed administration expenses for allowing the defaulting subsidiary to remain in possession.
>
> "*** guarantor has received a benefi' following its Chapter XI for which it should pay administration

> expenses. That benefit consists of the undisturbed occupancy of the subsidiary."

Although heretofore we have set forth the facts, at the risk of repetition, we point out that Judge Babitt's decision contains factual findings supporting all the foregoing.

> "The guaranteed lease here is clearly an asset of the subsidiary lessee. It cannot be less an asset of the parent-guarantor. The parent surely has an interest in the future performance by the claimant, the lessor of the subsidiary's lease. Can it be said that UNISHOPS, as parent, had no interest in its child's lease where that lease was a valuable asset of the child thereby contributing to its net worth? When, on March 1, 1974, the subsidiary lessee experiencing difficulty, begins to default, the parent-guarantor's interest becomes apparent, for its subsidiary continues to remain in possession of MIDDLETOWN SHOPPING CENTER, and continues to collect rents from its sub-lessees. That income, undiminished by payments of rent due the subsidiary's lessor, enhances the parent's assets. It simply cannot be accepted that the lessor (claimant here) would have permitted the subsidiary lessee to remain in possession and continue its defaults for six months were it not for the guarantee of the parent-guarantor to make the defaults good."
> (Underscoring Ours)

These are findings of fact which unless clearly erroneous under well settled law, should be accepted by this Court. If there are any questions as to their basis, this proceeding should be remanded to Judge Babitt for the taking of further testimony.

No finding of fact is necessary to indicate the in-

equitable situation which arises by denial of administration status to the claim. The parent-debtor will have had a free ride although it failed to file concurrently for its subsidiary and attack the lease. The inequity presented was probably present in GRAYSON, but since it had not been disclosed to the Court, a decision followed which refused to attribute an executory character to the guaranty.

GRAYSON was the only reported case where a parent holding company DIP made use of the premises through its subsidiary's lease where the subsidiary for a prolonged period did not file in Chapter XI. The parent was reaping the benefits of the lease without placing its asset under the Court's jurisdiction.

The same situation prevails in the case at bar, but here there is a full record of facts absent in GRAYSON. Undoubtedly this Court in GRAYSON, had in mind the possibility of a fact pattern adequately developed whereby the inequities of the situation could and should lead to a conclusion that the guaranty was executory. Surely the Court's opinion opens the door on a fully developed fact situation for a conclusion thereunder that a guaranty may be executory, constituting a valid claim for administration expenses for use and occupancy. Under the protection of the guaranty, and the claimant withholding action in reliance on the guaranty, for a period of seven months, the DIP parent had the benefit of being able to maneuver, manipulate and handle through its subsidiary and otherwise, the asset of the lease without incurring

the expense of its subsidiary's Chapter XI proceeding and without the supervision or control of the asset by the Court and a Creditors' Committee. Had UNISHOPS not had the use of the asset of the MIDDLETOWN lease and benefits flowing to it from said lease it would not have been able to continue as a viable entity in Chapter XI. This alone should be sufficient benefit to bring the situation within the aegis of estate preservation constituting an administration expense. The possibility of such considerations presumably led this Court in GRAYSON to leave the door open if a proper fact pattern were presented to it.

There can be no question but that a significant part of the UNISHOPS' estate was claimant's lease to UNISHOPS' wholly owned subsidiary MIDDLETOWN, and in turn, the subleases which the subsidiary had made. We cannot divorce the parent from the subsidiary. Throughout the present Chapter XI proceeding it presented consolidated statements to the Court. The parent's subsidiary, WHITE'S DEPARTMENT STORE, paid the rent to claimant for three months after the parent had filed in Chapter XI. Would it have done so if the lease was not profitable to it? It could have forthwith projected its subsidiary into Chapter XI and disaffirmed the lease. Profit no doubt resulted from the subsidiary's subleases. Obviously it was the guaranty which created the asset

of the lease and continued it as an asset because, but for the guaranty, the claimant would never have become the lessor. Claimant would not have paid $4,000,000 for the fee unless as part of the deal it obtained the guaranty. Even after the default, it was the guaranty which resulted in continued possession of the guarantor through its subsidiary's sub-lessees. Obviously, but for the guaranty, the claimant would have insisted forthwith upon payment or return of possession.

It cannot be said that when claimant leased to MIDDLETOWN, UNISHOPS, its guarantor and parent, received all the performance to which it was entitled. Such assertion would rest on the narrow, artificial premise, that all that was involved was a promise to pay, if MIDDLETOWN, its subsidiary, did not pay. This ignores the realities of the situation borne out by the very facts of the case. The guarantor expected and received a continuing relationship wherein benefits would and did inure to its subsidiary lessee, said benefits depending upon and arising out of the lessor's continued performance of the lease. Precisely such expectation was rewarded, as evidenced by the fact that the lessor forbore from evicting the defaulting subsidiary-lessee for seven consecutive months while UNISHOPS as DIP received benefits. If it had not been receiving benefits it would have required the lessee, its subsidiary, to file in Chapter XI and reject the lease. (See p. 12 of Judge Babitt's Opinion, focusing upon direct benefit to guarantor as opposed to lessee).

If, at the threshhold of the transaction, UNISHOPS

had reason to believe that the prospective landlord was not going to perform, it would not have permitted its subsidiary to become the lessee on the ground that little benefit would be derived by a lessee and itself. We have, in effect, a quasi third party contract. The guarantor, UNISHOPS, says to the prospective landlord-claimant, if you will give me $4,000,000, a lease to my subsidiary MIDDLETOWN, and perform the lease, I will convey you the fee and guaranty that my subsidiary will pay the rent.

We are not unmindful of the statement in GRAYSON, that the guarantor has no interest in the lessor's performance since if the lessor does not perform, the lessee is released and no liability will devolve upon the guarantor. However, we respectfully point out that in realty, parties contract in anticipation of performance. If their expectation is non-performance in limine they don't contract.

Judge Babitt, after discussing at length all the facts and circumstances which led him to the opinion that UNISHOPS' claim should be allowed as an administration expense, on the basis of GRAYSON and Wolfe-Rechtman, 29 Am. B.R. (N.S.) 756, concluded that the claim must be classified as general. We have demonstrated that GRAYSON does not compel that conclusion. We shall demonstrate that WOLFE-RECHTMAN does not compel it.

In that case the obligee of a guaranty was the bankrupt's sole creditor. An asset of the estate was the proceeds of the bankrupt's disability insurance policy. He claimed it was exempt under Section 55B of the Insurance Law and sought

to compel the Trustee to return the policy to him. The Court held that said section could not constitutionally, retroactively cut off the right of the obligee under the guarantee and of the Trustee to the policy because the guaranty had been signed before Section 55B had been enacted. The bankrupt's disability and the default as to the guaranty had eventuated prior to his bankruptcy and he had been receiving disability payments prior thereto. Thus, two pre-bankruptcy contingencies had occurred creating his right to the proceeds. The Court held it would be unconstitutional to permit subsequent statutory enactment to cut off prior established rights. Therefore the Trustee was entitled to retain the policy, and the bankrupt's motion for its return was denied. No question of provability, allowability, general or priority claim was involved. The Court enunciated the postulate which controlled Judge Babitt as follows:

> "The guaranty agreement was a complete obligation of payment which became absolutely effective on the day of its execution."

Hereafter we shall address ourselves to the question as to the meaning of the word "effective", but first to throw light on the problem we refer to Dunbar v. Dunbar, 190, U.S. 340, Merrill & Baker, 186 F. 312, and Maynard v. Elliott, 283 U.S. 273. These cases deal with the question of provability of claims.

Section 63 of the Bankruptcy Act determines what claims are provable. Contingent claims are provable under subdivision 8 of Section 63, but under Section 57(d) contingent claims are not allowable unless the Court determines that the claim is capable of liquidation or of reasonable estimation. Further, under Sec-

tion 63, subdivision d, if such a claim is ultimately determined to be not allowable, it is not deemed provable.

In DUNBAR, the Court had under consideration the bankrupt's obligation to support his wife during her life or widowhood. The Court pointed out "the innate difficulty, if not impossibility of estimating or valuing the particular contingency of widowhood." Thus the claim would not be allowable in bankruptcy and was non-dischargeable.

In MERRILL & BAKER, the Court said:

> "*** no plainer instance of liabilities neither presently due or capable of liquidation at the time of bankruptcy can be imagined than these claims of Jackson. There was no certainty that anything ever would be due, no certainty as to what would be due if liability ever arose."

In MAYNARD, the Court discusses DUNBAR and MERRILL & BAKER, and then formulates a category of claims as follows:

> "The contingency of the bankrupt's obligation may be such as to render any claim upon it incapable of proof. It may be one beyond the control of the creditor, and dependent upon an event so fortuitous as to make it uncertain whether liability will ever attach."

Describing a category to fit the claim which the MAYNARD Court had nder consideration it observed "*** some contingent claims are deemed not provable ***." (underscoring ours)

Appellants' claim, on November 30, 1973, when UNISHOPS filed in Chapter XI fitted precisely within the aforesaid category.

Returning to the language of WOLFE-RECHTMAN, that under a guaranty "there was a complete obligation of payment *** absolute-

ly effective on the day of its execution." We note that two predicates of allowability had occurred prior to bankruptcy, namely, the bankrupt's disability and the default under the guarantee. Suppose the two contingencies had not come to pass before the enactment of Section 55B. Surely the Court, if it took into account the tenets of provability as enunciated in the three cases, would not have said the guarantee obligation of payment was complete before the enactment of Section 55B. The language of WOLFE-RECHTMAN is understandable in light of the fact that the contingencies had occurred prior to the statute.

As recognized in MAYNARD v. ELLIOTT, citing MERRILL & BAKER and DUNBAR v. DUNBAR, when UNISHOPS filed its Petition and for several months thereafter, claimant merely had an inchoate, potential but then not yet a provable, let alone an allowable claim. The contingency had not only not yet occurred, but might never occur, and was beyond the control of claimant to effectuate.

Accordingly, can UNISHOPS' obligation under the guaranty be regarded as a complete obligation of payment effective on the day of its execution prior to the filing of its Petition in Chapter XI? We must note that the WOLFE-RECHTMAN pronouncement was with respect to (a) then existing state of facts, and (b) had no relation to claim classification for purposes of distribution, but (c) was relevant in context to the

constitutional question posed in the case. How can an "obligation of payment" become "completely effective" the day the guaranty is signed when it is then completely unprovable, unallowable, unenforceable. Besides it was then undeterminable whether it would ever be provable, allowable and enforceable. It was beyond the power of the obligee to create provability, allowability or enforceability. All these attributes of the claim followed it through several months of UNISHOPS' Chapter XI proceeding.

An effective unenforceable obligation is a contradiction of terms. The only rational meaning of an effective obligation of payment at any time is that it is then provable and allowable.

Within the guidelines of the three cases, the claim would not have been provable. Section 63(d) of the Bankruptcy Act mandates the same conclusion. The "obligation of payment" was certainly not effective when the paper was signed, might never so become and certainly was not when UNISHOPS filed its Chapter XI proceeding.

Judge Babitt's application of the WOLFE-RECHTMAN language in effect applied retroactively a state of facts which had occurred long after the signing of the guaranty and several months after the filing in Chapter XI. This application construes the language without reference to the context out of which it arose and without a consideration of the guide-

lines suggested by the three cases for a determination of provability. Such application sets at nought the usual "benefits" or "cost of operation" approach which removes a claim from the category of general to the category of priority.

There are further grounds mandating the conclusion that the $412,000 claim is entitled to priority status.

UNISHOPS should be regarded as the lessee. There would be no question that if UNISHOPS signed the lease the claim against it would be denominated as administration expense liability for seven months.

While in Merrill & Baker, 186 F. 312 (2d Cir), a claim on the guaranty of a loan was expunged because not provable, the Court's discussion of the liability of a parent being the same as that of its subsidiary is here applicable.

In that case, one Jackson, had made a loan to Brainard Corporation which was a subsidiary of the guaranteeing Bankrupt. The Court said:

> "Merrill's business was that of the Bankrupt corporation. That corporation conducted its affairs through certain subsidiary corporations whose stock was substantially owned by Merrill & Baker. So far as Jackson was concerned, the corporations of Merrill & Baker, of C. T. Brainard & Co., and others were all alike - they were merely the different parts of his friend Merrill's business *** Jackson, at

> the request of Merrill, loaned to C. T. Brainard & Co. a corporation controlled by Merrill & Baker, $24,387.50*** *** The actual and expressed consideration for this guaranty was that most of the money loaned by Jackson to Brainard & Do. was to be immediately handed over to the controlling corporation of Merrill & Baker for its own uses and purposes."

The foregoing language may be paraphrased to fit our case.

> "UNISHOPS' business was that of MIDDLETOWN and WHITE'S DEPARTMENT STORE. UNISHOPS conducted its affairs through subsidiaries whose stock it owned. The consideration to the guarantor through the subsidiary was to have control for its own purposes."

So far as claimant was concerned, the corporations, UNISHOPS and MIDDLETOWN and the others were all alike. They were merely different facets of UNISHOPS' business. UNISHOPS, for instance, used a subsidiary holding company, WHITE'S DEPARTMENT STORE, to pay shopping center rental. Furthermore, UNISHOPS, alone had meaningful assets, ergo claimants insisted upon its guaranty, and therefore the guarantor should be considered the

same as though it actually signed the lease.

Many are the cases which support the view that liability may be enforced against the parent corporation acting through its subsidiary.

See: U.S. vs. Reading Co., 253 U.S. 26;

Shanik vs. Aller, 52 N.Y.S. 2d 87.

That the liability of the subsidiary in the case at bar under the lease should be viewed as the liability of the parent as though the latter had signed the lease is clear from the close nexus between them. The operative facts have hereinbefore been discussed.

Furthermore, its obligations under the guaranty were co-terminus with those of the lease. Obviously, therefore it should make no difference that the obligor did not physically sign the lease. It should be bound thereunder the same as though it did.

UNISHOPS may also be regarded as though it had actually signed the lease by virtue of its adoption thereof by a course of conduct after it filed in Chapter XI. It caused payment of rent to be made for four months of its debtor-in-possession tenure, evidencing a clear intent to adopt under applicable case law. During the first seven months of its debtor-in-possession existence it could at any time have terminated the lease by projecting its subsidiary into a Chapter XI proceeding and having it move therein for disaffirmance of the lease. Eventually after the seven months it did just that.

For its own purposes it kept the lease alive for the entire period receiving the many benefits to which reference has hereinbefore been made. The signatory-lessee was merely its alter ego acting as its agent. The benefit of the lease inured not to said subsidiary company signatory but to UNISHOPS.

Under the Bankruptcy Act §70b, 60 days is the period during which a Trustee must elect to reject or assume an existing contract. See In Re Chase Commissary Corporation, 11 F. Supp. 288 , for a similar time limitation in reference to a debtor-in-possession. Four consecutive months of payment of rent by DIP UNISHOPS constitutes its adoption in its capacity as DIP of the guaranty by conduct. Also the acts of UNISHOPS in permitting its subsidiary to remain in seven months' possession for UNISHOPS' benefit and payment of rent and refusal to vacate or assign subleases are equivalent to an adoption of the guaranty and/or lease.

The inequity of not holding the parent to the obligation of the guaranty is pointed out by Judge Babitt. Equity mandates that the guaranteeing parent having received the benefits of the lease should be held liable as though it had signed the lease.

Claimant's forebearance should not prejudice it. The first default under the lease occurred on March 1, 1974 and the very next day claimant could have taken steps to have the tenant ousted or pay the March rent. Surely Judge Babitt, the Bankruptcy Judge, upon appropriate application in the UNISHOPS proceeding, would have compelled an election in any one of the seven months of accrual, either to pay the rent, to project your subsidiary into Chapter XI and disaffirm, or to direct your subsidiary to vacate and surrender possession.

On each successive month or cumulatively claimant could have successfully petitioned the Court for the same relief.

See: Preston v. Hawley, 139 N.Y. 296,

McCready v. Londontown, 172 N.Y. 400,

Lorillard v. Clyde, 122 N.Y. 41, and

Kennedy v. N.Y., 196 N.Y. 19.

Had claimant followed the aforesaid procedure there would have been no need for the instant claim. Its forebearance as pointed out hereinbefore was of substantial benefit to UNISHOPS. In all fairness it should not be penalized by the classification of its claim as general because it relied on the guaranty of UNISHOPS. It is clearly New York law that a landlord does not forfeit rent for intervening months of default by claiming for a period of months cumulatively. This the Court below found to be New York law.

The waiver provisions of the guaranty mandate its acceptance as an administration claim. It provides:

> "The guarantor further waives any defense arising by reason of any cessation of liability on the part of the lessee as a result of any voluntary or involuntary bankruptcy or other insolvency proceeding involving lessee *** The obligations of guarantor hereunder shall continue until the expiration of the original term of the lease ***."

The decision of Judge Babitt relegated UNISHOPS' claim to the position of a general claim. To the extent that claimant

thereby will not receive payment of the full amount due from and unpaid by the lessee, UNISHOPS may be deemed to have gained acceptance of a partial defense. This runs counter not only to the intent and purpose of the above quoted language but contravenes that language. The express inclusion thereof was a bargained for element in the four million dollar purchase and leaseback.

In summary, Judge Babitt did not grant administration expense status to the claim simply because GRAYSON had not chartered factual criteria under which a guaranty could be regarded as a continuing benefit and an expense of administration to a DIP entitling it to be regarded as executory. However, Judge Babitt found and stated many facts which he said mandate just such a conclusion. We submit therefore, that this Court, adopting the facts found by Judge Babitt, should adopt the conclusion which he strongly considered appropri[illegible] by reason of the facts, namely, the guarantee constituted benefit to the DIP and should therefore be one of its administration expenses.

Judge Frankel merely said he was not "prepared to share the Bankruptcy Judge's reservations about that decision (GRAYSON)." He questions the ability of the non-bankrupt lessee to disaffirm the lease. If it was not beneficial to both lessee and parent guarantor, the latter could have projected its child, the lessee, into Chapter XI and disaffirmance could be obtained.

Judge Frankel does not discuss Judge Babitt's findings of fact indicating clear benefit to the DIP guarantor. He brushes off these findings by merely say that "special facts arising out

of the guarantor's relationship to the lessee were of no moment". No reason why is suggested.

In summary, appellant should not be penalized for his forebearance. UNISHOPS should not be permitted to assert defenses, having waived same in the guaranty. It should be regarded in the same category as though it actually signed the lease either by virtue of its corporate setup operating through subsidiary, or by virtue of the facts indicating that it received all the benefits thereunder. These benefits should be a basis on which the claim should be granted an administration expense status.

POINT II.

THE $42,000 CLAIM SHOULD BE AN ADMINISTRATION EXPENSE CLAIM.

Judge Babitt based his decision honoring this claim as an administration expense on several grounds: Applying New York law to his fact finding, he concluded that MIDDLETOWN'S attempt to surrender the premises to UNISHOPS was ineffectual. Also, under New York law, he held that the possession of the premises by MIDDLETOWN'S subtenants was equivalent to MIDDLETOWN'S possession. However, he said that "New York law is not really necessary to resolve (the) legal dispute" since as per American Anthracite v. Bituminous Coal, 280 F. 2d 119, the "right to collect the rents clearly constituted benefit" and "accordingly claim No. 3 is entitled to administration status."

Judge Frankel in reversing, postulated the proposition

(supported by cases cited in his opinion) that trustees and receivers are not liable to landlords for use and occupancy by virtue of DIP's subtenants' possession or the trustee's or receiver's collection of rents or making repairs. In other words, a predicate of liability of trustees and receivers must be actual as distinguished from constructive possession. He then cited Brotherhood etc. v. Rea Express, 523 F. 2d 164 and Shopmen's etc. v. Kevin etc., 519 F. 2d 698, to the effect that an insolvent becomes a different entity when it becomes a debtor-in-possession. He concludes therefore, that the contracts of the previous entity are not the contracts of the DIP unless assumed.

There are a number of fatal defects in this line of reasoning. It assumes that a DIP, becoming a different entity from that of its precedent status, is the same as a trustee or receiver. The fact that two colors are different do not make them the same as a third color. Is the difference sufficient to support the conclusion that when such court officers are not involved, the DIP for all purposes is a different entity from that of its precedent status? How different is it? That there are differences is obvious. Also there are similarities. The DIP has certain rights, liabilities, privileges and immunities which it did not possess in its previous existence. However, it has the same officers, stockholders, debts and assets as its predecessor. It would be as irrational to argue that similarities dictate the conclusion, that the DIP assumes its precedent contracts, as to argue that its dissimilarities dictate that its precedent contracts are not assumed.

The question must be examined in logical fashion as an original proposition. Are the differences between a DIP and its predecessor of such nature that it cannot under any circumstances be held to the liability of an executory contract such as a lease? That a trustee or receiver enters the picture untrammelled by the insolvent's prior contracts flows from its relation to the situation. Trustees represent creditors as was stated in AMERICAN ANTHRACITE supra. DIPs do not. There is reason therefore why courts are less likely to hold its own court appointees bound by the insolvent's prior executory commitments. Less should be required to hold the DIP bound by its prior executory commitments.

Collier on Bankruptcy Vol. 3A 14th edition at page 1514, discussing Meehan v. King, 54 F. 2d 761 cited by Judge Frankel states:

> "But this proposition should be accepted with caution, because it rests on a case in which the acting officer of the court was a receiver who did not acquire title to the leasehold and whose only duty was to preserve the estate, and besides the referee later expressly ordered the collected rents to be handed over to the lessors so as to avoid even the semblance of an affirmance."

In the McCrory case, 69 F. 2d 21, also cited by Judge Frankel, the Court said:

> "Any right of the trustee in the leasehold was not a title thereto but an option to acquire title if acquisition should seem to the trustee best for the estate *** The Trustee *** acquired no more under the order *** than the right to adopt the lease of the premises ***."

In the MEEHAN case (supra) the Court said:

> "The subtenants held possession by virtue of contracts with the bankrupt, and not by virtue of any contract with the Receiver *** The possession of subtenants under leases made before bankruptcy cannot be construed as occupation by the Receiver; their contracts were with the bankrupt."

In the case at bar there was no receiver or trustee. It was the non-court appointee MIDDLETOWN who put the subtenants in possession. There is every reason therefore to hold that its subtenants, and its right to collect the rents are chargeable to it. Until disaffirmance becomes effectual, MIDDLETOWN should be held accountable for the rent. Its very attempt to surrender the premises, though held ineffectual by Judge Babitt, indicates that it regarded itself as in possession.

Under the circumstances, there should have been prompt disaffirmance of the lease. Prolonged failure to act should be construed to constitute assumption of the lease effective at the very time when MIDDLETOWN filed in Chapter XI with a right of disaffirmance.

True MIDDLETOWN moved promptly in relation to the time it became a DIP. However, regarding it as the subsidiary child of its parent guarantor, its status as a lessee was unduly prolonged. At any time after the parent went into Chapter XI it could have projected its child into Chapter XI and effected disaffirmance of the lease. It chose to wait nine months to secure interim benefits. The least that can and should be said is that the parents' delay

should be chargeable to the child who should be held for the one month of September rent.

The BROTHERHOOD & SHOPMEN'S cases (supra) clearly are distinguishable and do not compel a result different from that herein urged. In both cases this Court was faced with a dilemma. How could it reconcile the conflict between the National Labor Relations Act and the Bankruptcy Act? The former would prevent a DIP from disaffirming its contract with the Union, the latter would permit it. The dilemma was resolved by stating that the DIP was a different creature from its predecessor. Does that mean that for all purposes and whatever results different circumstances dictate nevertheless that principle must govern? We suggest that the problem involved in those cases evoked and justified the principle applied. We urge that the discussion and facts herein set forth do not require the application of that principle and such application under said facts would result in inequity.

CONCLUSION

The order of the District Court should be reversed and both claims classified as priority administrative expense claims.

Respectfully submitted,

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